VIERSON & COCHRAN

IBLA 82-616 Decided September 1, 1982

Appeal from decision of the New Mexico State Office, Bureau of Land Management, rejecting the high bid for competitive oil and gas lease NM 51848 (Okla.).

Set aside and remanded.

1. Oil and Gas Leases: Competitive Leases -- Oil and Gas Leases: Discretion to Lease

   The Secretary of the Interior has the authority to reject a high bid in a competitive oil and gas lease sale where the record discloses a rational basis for the conclusion that the amount of the bid was inadequate.

2. Oil and Gas Leases: Competitive Leases

   Where the high bid in a competitive oil and gas lease sale is rejected as inadequate and on appeal the bidder raises considerable doubt whether the bid is, in fact, inadequate, the decision rejecting the bid may be set aside and the case remanded to BLM for reconsideration of the bid.

APPEARANCES: W. Gregory James, Esq., Tulsa, Oklahoma, for appellant; John H. Harrington, Office of the Field Solicitor, Department of the Interior, Santa Fe, New Mexico, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE HARRIS

Vierson & Cochran has appealed from a decision of the New Mexico State Office, Bureau of Land Management (BLM), dated February 16, 1982, rejecting its high bid of $252 per acre for parcel No. 23 at the competitive oil and gas lease sale held on December 22, 1981. 1/ BLM stated that the Deputy Conservation Manager for Resource Evaluation, Minerals Management Service (MMS), 2/ Albuquerque, New Mexico, recommended rejection of the bid because it was lower than the MMS presale evaluation of the parcel. The MMS presale evaluation was $400 per acre.

On appeal appellant claims that the gas price and gas price adjusted for associated liquids used by MMS in its calculations of well economics are "substantially greater than that which can be reasonably expected." Appellant charges that the factor of 0.133 calculated by MMS as an adjustment for associated oil production per Mcf of gas was based on data from a well test taken in March 1974 on an existing well located in sec. 4, T. 21 N., R. 13 W., Major County, Oklahoma, and as such, the factor is too high. Appellant contends that actual production history from that well provides more accurate figures and that 263,503 Mcf of gas and 11,159 barrels of oil, through September 1981, indicate an adjustment factor of 0.0423. Further, appellant asserts that the current gas price paid in the area is 80 percent of the price set pursuant to section 103 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3313 (Supp. II 1978). Based on these factors, appellant provides the following table of prices in its statement of reasons at page 3:

	BLM	Appellant
Estimated equivalent gas price per Mcf for associated oil produced		
Low	$4.23	$1.34
High	$6.81	$2.16
Total estimated price per Mcf for gas plus associated liquids		
Low	$6.80	$3.40
High	$10.80	$5.32

Appellant urges that if its figure were used by MMS, its bid would have been considered adequate.

In response to appellant's statement of reasons counsel for BLM submits a report prepared by MMS responding to the statement of reasons and providing justification for the bid rejection.

MMS initially replies that presale evaluation is based on more than one factor, and merely because appellant has attacked one value used in the discounted cash flow (DCF) analysis does not undercut MMS reliance on comparable

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1/ Parcel No. 23 contains 80.25 acres in T. 21 N., R. 13 W., Indian meridian, sec. 4 (lot 2, SW 1/4 NE 1/4) in Major County, Oklahoma.
2/ By Secretarial Order No. 3071 published in the Federal Register on Feb. 2, 1982, 47 FR 4751, the Secretary created the Minerals Management Service to, inter alia, take over the functions of the Conservation Division, Geological Survey.

sales techniques. 3/ MMS states that using either DCF or comprable sales, appellant's bid is "markedly below the pre-sale estimate."

MMS next concedes that the use of actual production figures, as provided by appellant, to calculate the gas price adjusted for associated liquids is "well taken." MMS concludes, however, that even if appellant's "unsubstantiated price estimates" are used, the result is not changed if the risk factor is changed from 40 percent to 70 percent. MMS justifies the increase in the risk factor because of the number of successful wells in the surrounding area. 4/

Appellant attacks the MMS report by arguing that the reference to the bid of $389 per acre for a parcel in June 1981 was "during the peak of the mid-1981 frenzy within the industry." Appellant points out that only two bids were received for parcel No. 23. Viking Resources bid $5 per acre and appellant bid $252 per acre. Appellant states that every parcel is unique and the bids received for parcel No. 23 should indicate that it is not as economically attractive as others.

Appellant also challenges MMS reference to "unsubstantiated price estimates of appellant." Appellant asserts that its price estimates are based on actual experience. 5/ Appellant further argues that MMS's rationale for increasing the risk factor from 40 percent to 70 percent--that "this tract is literally surrounded by successful wells" was known at the time MMS evaluation personnel made the original DCF analysis using the 40 percent figure. Thus, appellant argues that there is no justification for using a 70 percent risk factor in a new DCF analysis.

3/ MMS stated:

"The appellant, Vierson and Cochran, is basing his appeal on one value used in the discounted cash flow (DCF) analysis of the subject tract. As noted in the recommendation for rejection of the high bid (Exhibit B), the presale evaluation is based on both a DCF and on comparable sales techniques. A Federal parcel in sec. 3, T. 21 N., R. 14 W. sold for $389.00 per acre in June, 1981. Also, in Major County, Oklahoma, between December 2, 1980 and October 20, 1981, the average state lease sale was $346.51 per acre with a range between $252.76 and $481.76 per acre. Using either technique, his bid is markedly below the pre-sale estimate."

4/ MMS stated:

"In any DCF analysis, certain assumptions are included in estimating the presale value of a tract. Exhibit E includes the risk factor of 40 percent for a successful well and the original prices which are applied in this case. When the DCF analysis is recalculated using the unsubstantiated price estimates of the appellant, a change of the risk factor from 40 percent to 70 percent gives the same results. This tract is literally surrounded by successful wells completed in the Chester and Mississippian reservoirs (Exhibit F). An increase in the likelihood of a successful well is justified by the surrounding successful wells."

5/ Attached as exhibit A to appellant's reply brief is a copy of an amended contract between appellant and Phillips Petroleum Company for the sale of gas from a well in sec. 34, T. 22 N., R. 13 W., Indian meridian, setting a price of 80 percent of the Natural Gas Policy Act price.

[1] The Secretary of the Interior has discretionary authority to reject a high bid for a competitive oil and gas lease as inadequate. 30 U.S.C. § 226(b) (1976); 43 CFR 3120.3-1. This Board has consistently upheld that authority so long as there is a rational basis for the conclusion that the highest bid does not represent a fair market value for the parcel. Harold R. Leeds, 60 IBLA 383 (1981); Harry Ptasynski, 48 IBLA 246 (1980); B. D. Price, 40 IBLA 85 (1979). Departmental policy in the administration of its competitive leasing program is to seek the return of fair market value for the grant of leases and the Secretary reserves the right to reject a bid which will not provide a fair return. Coquina Oil Corp., 29 IBLA 310, 311 (1977). See Exxon Co., U.S.A., 15 IBLA 345, 357-58 (1974).

The Board has consistently held that while BLM is entitled to place great reliance on MMS's technical expertise, the decision rejecting a high bid is that of BLM and, thus, BLM must analyze independently the question of sufficiency. William C. Welch, 60 IBLA 248 (1981); see also Southern Union Production, 51 IBLA 89 (1980); Steven Lutz, 39 IBLA 386 (1979).

[2] In this case the presale evaluation appears to have been grounded on two bases--the DCF analysis and comparable sales. First, we will examine the DCF analysis. Appellant argues that the original DCF analysis is erroneous because MMS failed to use actual production figures in its calculations. MMS stated that appellant's comments on this point were "well taken." Yet, MMS sought to negate the impact of appellant's figures by stating that even if appellant's figures were used, a change in the risk factor from 40 to 70 percent would give "the same results." We agree with appellant that there can be no justification for such an increase. If MMS presale evaluation personnel believed a 40 percent risk factor was proper at the time their evaluation was made, then such a factor should be appropriate regardless of the figures used in the DCF analysis.

It appears that the actual production figures provided by appellant on appeal more accurately represent the proper figures for the DCF analysis. MMS's post hoc rationale that use of such figures with a 70 percent risk factor still results in a $400 per acre figure cannot be justified. Proper calculation would require application of a 40 percent risk factor. Therefore, we must conclude that appellant has successfully challenged the first basis of the presale evaluation.

The second basis claimed by MMS as support for its evaluation is comparable sales. It states that a nearby Federal parcel sold for $389 per acre in June 1981 and that state lease sales in the area have ranged between $252.76 and $481.76 per acre between December 2, 1980, and October 20, 1981. Appellant asserts that the $389 per acre bid was made when activity and interest in the area was at a peak. Appellant's bid of $252 per acre is at the low end of the state lease range. However, it is clearly not spurious or unreasonable. We find that the comparable sales data in this case by itself does not support the rejection of appellant's bid.

In this case appellant has raised considerable doubt whether its bid of $252 per acre is inadequate. For this reason, the BLM decision must be set aside and the case remanded to BLM to allow recalculation of the DCF using appellant's adjustment factor of 0.0423. Further, in the absence of a showing of error in appellant's use of 80 percent of Natural Gas Policy Act price, the recalculation should be based on such a price. In addition, the 40 percent risk factor must be applied as that factor was used in the presale evaluation, and to change that factor merely for the purposes of recalculation would be arbitary and capricious. Since we have determined that appellant's bid may not be rejected on the basis of the comparable sales data alone, if recalculation results in a per acre evaluation such that appellant's bid of $252 per acre can be considered adequate, BLM should accept appellant's bid as the high bid, and issue a lease, all else being regular.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is set aside and the case remanded for action consistent with this decision.

Bruce R. Harris
Administrative Judge

We concur:

Anne Poindexter Lewis
Administrative Judge

C. Randall Grant, Jr.
Administrative Judge